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FEDERAL COMMUNICATIONS COMMISSION
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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of	)	
	)	
Implementation of Section 302 of	)	CS Docket No. 96-46
the Telecommunications Act of 1996	)	

Comments of the Staff of the Federal Trade Commission
and the Antitrust Division of the Department of Justice
In Opposition to Petition for Reconsideration

July 15, 1996

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List A B C D E

The Staff of the Federal Trade Commission[1] and the Antitrust Division of the Department of Justice offer this joint comment in opposition to the Petition for Reconsideration of the National Cable Television Association, Inc., insofar as that petition asks the Federal Communications Commission to reconsider its decision to permit the operators of Open Video Systems ("OVS") to limit the ability of competing, in-region cable operators to demand carriage of their programming on the OVS.

The Federal Trade Commission and the Antitrust Division are responsible for maintaining competition and safeguarding the interests of consumers. Both the Antitrust Division[2] and the

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1 This letter represents the views of the staff of the Federal Trade Commission. They are not necessarily the views of the Federal Trade Commission or any individual Commissioner. Inquiries regarding this comment should be directed to John Wiegand (415-356-5270).

2 U.S. v. Texas Television, Inc., C-9664 (S.D. Tex. 1996) (consent decree stemming from an agreement between three local television stations concerning retransmission consent negotiations with cable systems); U.S. v. Tele-Communications, Inc., CV-94-0948 (D.C. 1994)(consent decree requiring application of anti-discrimination provisions of Cable Act to distribution of programming to Regional Bell Operating Companies); U.S. v. Primestar, 93-CV-3913 (S.D.N.Y. 1994) (consent decree involving satellite-delivered programming). In addition, in 1991, the Division investigated and subsequently moved to vacate consent decrees with the three major television networks -- NBC, ABC, and CBS -- which prohibited the networks from, among other things, owning certain financial interests in television programs or participating in the syndication of television programs.

The Division has previously submitted comments in a variety of FCC proceedings in this area, including: (1) effective competition standards for rate regulation of basic cable rates (MM Dkt. No. 90-4); (2) evaluation of the financial interest and syndication rule (MM Dkt. No. 90-162); and (3) revision of rules and policies concerning Direct Satellite Broadcast services (IB Dkt. No. 95-168, PP Dkt. No. 93-253).

staff of the FTC[3] have wide experience in reviewing antitrust issues in the area of video programming distribution and other telecommunications issues.

This proceeding concerns the implementation of the portion of the Telecommunications Act of 1996[4] that relates to the establishment of OVSs.[5] Under the Telecommunications Act, a distributor of video programming, including a telephone company ("local exchange carrier" or "LEC"), may elect to transport video

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[3] Summit Communications Group, Inc., C-3623 (FTC, Oct. 20, 1995) (consent agreement arising out of allegations that competing cable providers entered into a market allocation agreement); TeleCable Corp., C-3575 (FTC, Oct. 19, 1994) (consent agreement arising out of TCI's acquisition of TeleCable Corp. required that TCI hold separate and then divest either its own cable assets, or those of TeleCable, in Columbus); In re Boulder Ridge Cable TV, C-3537 (FTC, Oct. 10, 1994) (consent agreement barring parties to a cable acquisition from enforcing an ancillary agreement not to compete within 15 miles of each other in any present or future market); In re Tele-Communications Inc., FTC File No. 941-0008 (FTC, accepted for public comment on Nov. 15, 1993) (Commissioners Azcuenaga and Owen dissenting)(consent agreement by which TCI agreed to sell all of its QVC stock if QVC succeeded in acquiring Paramount; agreement withdrawn when Viacom, rather than TCI, acquired Paramount).

The FTC staff previously has commented on various issues before the FCC, including: (1) elimination of the prohibition on common ownership of cable television systems and national television networks (CT Dkt. No. 82-434); (2) rules relating to whether cable television systems "must carry" television broadcast signals (MM Dkt. No. 85-349); (3) the FCC requirement that broadcast licenses be held for at least three years before being transferred (BC Dkt. No. 81-897); (4) competition and rate regulation for cable television service (MM Dkt. No. 89-600); and (5) effective competition for cable television service (MM Dkt. No. 90-4).

[4] Pub. L. No. 104-104, 110 Stat. 56.

[5] 47 U.S.C. § 571-73.

over its wires as either a common carrier, cable operator, or OVS operator.[6] OVSs will operate under a legal framework that is distinct from that of both common carriers and cable operators.[7] Like the Video Dial Tone ("VDT") systems that they replace,[8] OVSs will combine features of common carriers and cable systems.[9]

An OVS operator may act as a programming provider for at least one-third of the capacity of its own system.[10] An OVS operator is obligated to allocate the other two-thirds to unaffiliated video programming providers, but only to the extent that such program providers apply for channel capacity on the system.[11] The FCC is required to prescribe regulations that would prohibit an OVS operator from "unjustly or unreasonably" discriminating among these video program providers.[12] The Notice of Proposed Rulemaking raised the question of whether a decision by an OVS operator to discriminate against or to exclude a cable operator that is a direct competitor should be defined by regulation as just or reasonable.[13] The Second Report and Order concluded that an OVS operator should be permitted to discriminate against a competing, in-region cable operator to the

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[6] 47 U.S.C. § 571(a).

[7] 47 U.S.C. § 573.

[8] 47 U.S.C. § 573(b)(3) (repeal of VDT); In re Open Video Systems, ___ F.C.C. Rcd. ___, ¶ 2 (1996) (Report & Order & Notice of Proposed Rulemaking) (OVS similar to, and replacement for, VDT).

[9] In re Open Video Systems, ___ F.C.C. Rcd. ___, ¶ 1-3 (1996) (Second Report & Order).

[10] 47 U.S.C. § 573(b)(1)(B).

[11] *Id.*

[12] 47 U.S.C. § 573(b)(1)(A).

[13] In re Open Video Systems, ___ F.C.C. Rcd. at ¶ 15.

point of excluding it from providing programming to the system.[14] In addition, the Second Report and Order contemplates that competing, in-region cable operators which lack significant market power may petition to demand access on an OVS.[15] We agree with the FCC's conclusion on this issue and find it to be consistent with well established legal and economic principles.

In construing the antitrust laws, the Supreme Court has repeatedly stated that a restraint on competition is reasonable if it enhances consumer welfare.[16] Our inquiry, then, is focused on how discrimination against, even to the point of exclusion, a dominant cable operator by a directly competing OVS operator will affect consumer welfare.

When a dominant firm is protected by high entry barriers, efforts to lower those barriers to entry must be structured to prevent the dominant firm from seeking, either directly or indirectly, to thwart those efforts. The FCC has recently concluded that, "overall, cable television operators possess substantial market power."[17] Because these markets are protected by high entry barriers, local cable operators have been able to "maintain prices above the level that would prevail if the market were competitive."[18] Moreover, the FCC has already found that

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[14] In re Open Video Systems, ___ F.C.C. Rcd. ¶¶ 50-56 (codified at 47 C.F.R. § 76.1502(c)(2)(iv)(C)).

[15] *Id.* at ¶ 56 (lacking market share statistics, the rule permits cable operators with less than 20% penetration and fewer than 17,000 subscribers within the OVS's service area to petition the FCC for relief so as to demand carriage on a competing OVS).

[16] *See, e.g.*, NCAA v. Board of Regents, 468 U.S. 85, 98 (1984); Reiter v. Sonotone Corp., 435 U.S. 330, 342-44 (1979); *see also* Robert Bork, The Antitrust Paradox 61 (1978); Richard Posner, Antitrust Law 18-20 (1976).

[17] In re Annual Assessment of the Status of Competition in Video Programming, 9 F.C.C. Rcd. 7442, ¶ 212 (1994) (First Report).

[18] 1994 Cable Report at ¶ 131.

the delivery of video programming by LECs represents an important source of potential competition for dominant cable companies.[19] Furthermore, as the Notice of Proposed Rulemaking notes, Congress created OVS to provide competition and lower barriers to entry in the provision of video programming to consumers. To the extent that cable company incumbents have market power and there are high entry barriers, efforts by new entrants to offer competition in the provision of video programming will likely enhance consumer welfare, by reducing prices and increasing quality. A requirement that OVS operators must permit competing in-region cable systems with market power to have access to OVS channel capacity would impede such competition, as the FCC has concluded.

The NCTA petition argues that it is inappropriate for the FCC to adopt rules that permit discrimination against in-region cable systems, but not other video delivery system providers such as DBS and MMDS. But in-region cable operators, because of their market power in multichannel video programming distribution, may have different incentives with regard to the use of channel capacity on an OVS than would programming providers who do not have such market power. A cable operator may have an incentive to see that the OVS is not successful. It could, therefore, use a request for capacity on the OVS as a way to protect and continue to exploit its market power. Enabling a cable operator to demand capacity on an OVS means that less capacity will be available for use by the OVS operator, and for other firms that might want to use some of the OVS capacity. This could result in the OVS providing a service that, because of its relatively limited channel capacity, is a less attractive alternative to the incumbent cable system. This, in turn, could help preserve the cable operator's market power, thereby giving the cable operator a strategic incentive to demand capacity on the OVS.

Thus, mandated access for in-region cable systems could result in less effective entry from OVSs than would otherwise be the case. In the extreme, potential programmers that would otherwise use the OVS may decide that, if the cable company is allowed on the system, it will no longer be worthwhile for them

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[19] In re Annual Assessment of the Status of Competition in Video Programming, 11 F.C.C. Rcd. 2060 at ¶¶ 9, 86-103 (December 1995) (Second Annual Report).

to participate. Thus, less entry, overall, would occur. These factors could also reduce the value of the system to the OVS operator, since, overall, the programming will be less attractive and it will be marketed less aggressively. This, in turn, would lead to fewer subscribers than would otherwise be the case and may deter the construction of an OVS in the first place.

Concern about mandatory carriage of a dominant cable company's offerings may have already played a part in some LECs' decisions to abandon efforts to provide VDT, the precursor to OVS. In Georgia, BellSouth Corp. objected to a request by Scripps Howard Cable, the relevant community's dominant cable operator, for half of the capacity of its proposed VDT system.[20] In Connecticut, Southern New England Telecommunications Corp. objected to a request by Cablevision Systems Corp., the relevant community's dominant cable operator, for over half of the capacity of its proposed VDT system.[21] Both LECs have announced plans to convert their video distribution systems from VDT to traditional franchised cable, rather than to OVS.[22] These decisions to forgo development of OVS may rest, at least in part, on a concern that competing dominant cable companies will be able to demand carriage on OVS.[23]

Furthermore, as the FCC noted in the Second Report and Order, giving dominant cable companies the ability to demand carriage on OVS may also reduce dominant cable companies'

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[20] Ted Hearn, "Scripps Howard, BellSouth Battle Heats Up," Multichannel News 150 (8 May 1996); Ted Hearn, "Bell South Fights to Keep Cable Off Georgia VDT Trial," Multichannel News 1 (May 1, 1995).

[21] Kent Gibbons, "SNET Says It Can't Fill Rainbow's VDT Channel Order," Multichannel News 14 (June 5, 1995).

[22] Ted Hearn, "BellSouth Nabs Franchise in Chamblee, GA," Multichannel News 20 (April 22, 1996); Kent Gibbons, "SNET Drops VDT Plan, Goes Cable across Connecticut," Multichannel News 1 (January 29, 1996).

[23] Ted Hearn, "For Now, It Looks Like SOS for OVS," Multichannel News 142 (April 29, 1996).

incentives to develop and upgrade their own systems.[24] The cable company might recognize that, although it may lose some customers because of its failure to upgrade, some portion of those lost customers are likely to switch to the cable operator's products on the OVS system. Recognizing this, the cable operator would have less incentive to undertake investments to upgrade its cable systems and consumers would lose the benefits of such innovation-based competition.

Accordingly, we agree that the OVS regulations should be structured with a keen concern for the ability of an OVS operator to offer a service that is independent from that of a competing dominant cable operator. An OVS that is independent from competitors with market power will provide consumers with the benefits of competition.

We also believe that a bright-line approach that gives the OVS operator the right to discriminate against or outright bar a dominant cable competitor makes sense. Justifying a bright-line standard does not require a demonstration that permitting OVS operators to discriminate against, or even to exclude, dominant cable competitors from their systems is always good. Rather, a bright-line approach is efficient if it generates greater net social benefits than would the expected application of a case-by-case approach, taking into account the costs of: (1) discriminatory or exclusionary conduct by OVS operators that is wrongly permitted; and (2) enforcement.[25]

In this situation, it is doubtful that discriminatory or exclusionary conduct against a dominant cable operator by an OVS operator would harm consumers. In fact, if a cable operator in a market is the most efficient provider of programming for part or all of that market's OVS capacity, the OVS operator will generally have no incentive to discriminate against or to exclude the cable operator. Accordingly, there does not appear to be much possibility that consumers will be harmed from dominant

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[24] In re Open Video Systems, ___ F.C.C. Rcd. at ¶ 52.

[25] *See* Frank Easterbrook, The Limits of Antitrust, 63 Tex. L. Rev. 16 (1984); *see also* United States v. Container Corp. of America, 393 U.S. 333, 341 (1969) (Marshall, J., dissenting).

cable operators being wrongfully excluded from directly competing OVSs.

Considering enforcement costs, a bright-line approach is highly preferred in that its enforcement costs approach zero. In contrast, the costs of adjudicating disputes as to programming on VDT systems have been substantial. We believe that an approach that examines an OVS's discrimination against a competing dominant cable company on a case-by-case basis will replicate the conditions that hindered the development of VDT and will result in unnecessary costs and delays.

In this regard, we note that the Second Report and Order does provide an exception by which certain competing, in-region cable operators may petition the FCC for an exemption so as to be able to demand carriage on an OVS.[26] However, the specific exception cited -- for cable operators offering service to less than 20% of households and to fewer than 17,000 subscribers within the OVS' service area -- is a limited one, narrowly targeted to those cable operators who do not have a dominant market presence within the OVS's service area. In line with our concern that a case-by-case petitioning process may lead to unnecessary costs and delays for OVS operators, we would agree with the FCC's approach in defining this narrow exception.

In sum, we agree with the FCC's decision to permit an OVS operator to discriminate against, or even to exclude, a directly competing dominant cable company, and with its conclusion that such discrimination or exclusion is reasonable and just under the Telecommunications Act. This approach accords fully with the mandate of the Telecommunications Act that the FCC accelerate the emergence of competition in this market.

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[26] In re Open Systems, ___ F.C.C. Rcd. at ¶ 56.